80-582

Supreme Court, U.S.
FILED
OCT 7 1980
MICHAEL RODAK, JR., CLERK

NO. _____

IN THE UNITED STATES SUPREME COURT

OCTOBER 1980 TERM

J. M. ZACHARY, ET AL,

v. Petitioners

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent

NORTHERN NATURAL GAS COMPANY,

Intervenor

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR WRIT

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QUESTIONS PRESENTED

I.

Whether the court of appeals erred in affirming the Federal Energy Regulatory Commission's jurisdiction to determine questions of ordinary contract construction.

II.

Whether the court of appeals erred in affirming the Federal Energy Regulatory Commission's interpretation of a gas purchase contract as a "life-of-lease" contract, which had not expired, thus disqualifying the Petitioners from receiving the replacement contract rate.

III.

Whether the court of appeals deprived Petitioners of constitutional due process when it affirmed the Federal Energy Regulatory Commission's decision to deny Petitioners the right to an evidentiary hearing or oral argument.

LIST OF PARTIES

The following are Petitioners to the proceeding in the court below but were not included in the caption because of space limitations:

Estate of Neville Penrose

H. Barksdale Brown

Frank D. Brown

Jacques T. Schlenger

Mercantile Safe Deposit & Trust, Trustee of the Trusts U/D Donaldson Brown

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REFERENCE TO PROCEEDINGS BELOW

The court of appeals' decision is reported as: Zachary v. FERC, 621 F.2d 155 (5th Cir. 1980).

The FERC orders are as follows:

1. Order Granting Intervention and for Taking Action on Petition for a Declaratory Order, J. M. Zachary, et al, Docket No. RI76-123 (August 2, 1976).

2. Order Denying Rehearing, J. M. Zachary, et al, Docket No. RI76-123 (January 31, 1979).

Neither order is officially reported at this time.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit, issued as and for the mandate on July 31, 1980, was entered July 9, 1980. Jurisdiction is conferred upon the Supreme Court by 28 U.S.C. §1254 (1) (1966) which authorizes review of the judgments of the courts of appeals by writ of certiorari.

STATUTORY REFERENCES

Sections 4e and 5 Natural Gas Act [15 U.S.C.A. §§717c(e), d(a) (1976)]

Section 19 Natural Gas Act [15 U.S.C.A. §717r (1976)]

28 U.S.C. §1254(1) (1966)

See Appendix for text of statutes.

STATEMENT OF THE CASE

This Petition for Writ of Certiorari has its basis in a decision of what is now the Federal Energy Regulatory Commission which held that a gas purchase contract between Petitioners and Intervenor, Northern Natural Gas Company, has not expired or terminated according to its own terms. Hence, the Petitioners are ineligible to charge a higher rate under the Commission's replacement contract policy.

On March 15, 1954 a gas purchase contract covering various oil and gas leases on lands located in Lea County, New Mexico was entered into between predecessors-in-interest of the Petitioners and Northern.

Article VIII (1), captioned "Term" of the gas purchase contract, provides as follows:

> 1. Subject to the other provisions hereof this agreement shall be in force for an original term from its date until the expiration of a twenty (20) year period following the date

> hereof and thereafter as long as gas is delivered hereunder in quantities commercial to Seller and Buyer. [Emphasis added.]

On or about February 28, 1975, which was more than 20 years after the effective date of the gas purchase contract, Petitioners gave written notice to Northern that Petitioners would no longer deliver gas to it under the contract, and that it was terminated in accordance with its terms. Northern did not acquiesce in this interpretation.

Accordingly, Petitioners and Northern then negotiated and entered into an "Interim Agreement" on January 21, 1976 which allowed Petitioners to collect the higher replacement contract rate subject to a final determination as to the duration of the contract. The Interim Agreement required Petitioners to seek a declaratory judgment from the Federal Power Commission.

By order issued August 2, 1976 the Commission, impliedly accepting jurisdiction, held that the contract was a life-of-lease

contract. Thus, cessation of deliveries by Petitioners did not terminate the contract.

This construction was reaffirmed in the Commission's Order of January 1, 1979 denying Petitioners' Application for Rehearing. In this latter order, the Commission additionally maintained that it was not required to take evidence or to grant oral argument.

Petitioners appealed this decision to the Court of Appeals for the Fifth Circuit on July 9, 1980. That court's jurisdiction was based on Section 19 of the Natural Gas Act. 15 U.S.C.A. §717r (1976). The court affirmed the Commission's construction of the contract, determined that the Commission did indeed have jurisdiction to construe the contract, and concluded that the Commission was not required to grant an evidentiary hearing or oral argument.

A writ of certiorari is sought to review that judgment.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

I. The court of appeals' erred in affirming the Federal Energy Regulatory Commission's jurisdiction to determine questions of ordinary contract construction.

The court of appeals' decision upholding the Commission's jurisdiction to construe ordinary contract provisions conflicts with decisions of this Court which has held that absent a question involving the Commission's specialized knowledge in the administration of the Natural Gas Act, the Commission lacks jurisdiction under §4e and 5 of the Natural Gas Act, 15 U.S.C. §717c(e), d(a) (1976) to construe ordinary contract provisions. United Gas Pipe Line Co. v. Mobil Gas Service Corp, 350 U.S. 332 (1956); Pan American Petroleum Corp. v. Superior Court, 366 U.S. 356 (1961). Those provisions of the Natural Gas Act allow the Commission to determine only the reasonableness of rates. Id. The Natural Gas Act does not alter ordinary contract relationships. Id. Merely because the replacement contract

policy is involved does not mean that the question involves the Commission's specialized knowledge. Skelly Oil Co. v. FPC, 532 F.2d 177 (10th Cir. 1976). As observed by the Court in City of New Orleans v. United Gas Pipe Line Co., 390 F.Supp. 861, 865 (E.D. La. 1974): "The Commission may regulate many aspects of the gas supply contract but not even that agency has attempted to imply that the contractual relationship is itself a creation of federal law."

Thus, the court of appeals' decision does not accord with established precedent.

II. Whether the court of appeals erred in affirming the Federal Energy Regulatory Commission's interpretation of a gas purchase contract as a "life-of-lease" contract, which had not expired, thus disqualifying the Petitioners from receiving the replacement contract rate.

But even if the Commission had jurisdiction to construe the contract, the court of appeals' decision affirming the Commission's interpretation of that contract as a life-of-lease contract rather than one which

expired at the end of its 20-year primary term is inconsistent with other decisions of the court of appeals concerning similar clauses. In all previous decisions wherein the court had found a life-of-lease contract there was no stated primary term at the original execution of those contracts. Austral Oil Co. v. FPC, 560 F.2d 1262 (5th Cir. 1977); Superior Oil Co. v. FERC, 569 F.2d 971 (5th Cir.), cert. denied, 439 U.S. 834 (1978). These cases must be distinguished from Petitioners' contract which from the outset has had a clearly fixed 20-year primary term after which period Petitioners could terminate the contract by ceasing deliveries. No formal notice to terminate was necessary because the symbolic act of ceasing deliveries constituted notice. Thus, after twenty years, Petitioners' contract expired by its own terms.

This construction so far departs from past decisions in the court of appeals that the court should exercise its powers of supervision.

III. The court of appeals deprived Petitioners of constitutional due process when it affirmed the Federal Energy Regulatory Commission's decision to deny Petitioners the right to an evidentiary hearing or oral argument.

The Commission's construction of the contract, upheld by the court of appeals, is inconsistent with past decisions of the court of appeals because the Commission refused to take any evidence as to the parties' intentions regarding the term of the contract. Moreover, it refused to grant Petitioners even an oral argument. These fundamental rights were denied in the face of a contract which was factually ambiguous, i.e. the meaning of "commercial quantities" in the context of this contract. Moreover, these questions cannot be resolved without resort to extrinsic evidence. Hence, the court denied Petitioners a fundamental constitutional right to present their case. Morgan v. U.S., 298 U.S. 468 (1935); Joint Anti- Fascist Comm. v. McGrath, 341 U.S. 123 (1950). While there are some limited circumstances where an evi-

dentiary hearing or oral argument may be dispensed with, circumstances involving factual ambiguities is not one of them. In denying Petitioners that fundamental right the Commission had a "heavy burden of justification". Independent Bankers Ass'n. v. Bd. of Governors, 516 F.2d 1206 (D.C. Cir. 1975). This burden has not been met.

The Court should address this deprivation of constitutional magnitude.

Respectfully submitted,

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APPENDIX

J. M. ZACHARY et al., Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, Respondent.

No. 79-1754.

United States Court of Appeals, Fifth Circuit.

July 9, 1980.

Petition for Review of an Order of the Federal Energy Regulatory Commission.

Before CHARLES CLARK, RONEY and GARZA, Circuit Judges.

RONEY, Circuit Judge:

The issue in this case is whether a natural gas contract expired by its own terms, enabling the seller to then charge a higher rate under the replacement contract policy of the Federal Energy Regulatory Commission, 1/ when the seller stopped delivery under a contract which was to continue "as long as gas is delivered hereunder in quantities commercial to Seller and Buyer." We uphold the

Commission's determination that under its replacement contract policy the contract did not expire by its own terms upon the seller's cessation of delivery, there being no question that gas was still deliverable under the contract in quantities commercial to both the seller and buyer.

The replacement contract policy was adopted to effect the gradual elimination of the two-tiered "vintaging" rate structure See Austral Oil Co. v. FPC, 560 F.2d 1262, 1265-66 (5th Cir. 1977). A replacement contract qualifies for higher rates if the prior contract "expired by its own term." 2/ By allowing qualification for higher replacement rates only when a contract terminates in accordance with its terms, the Commission withheld from the contracting parties "unrestricted freedom to bring themselves within [the] ambit" of the policy. Superior Oil Co. v. FERC, 569 F.2d 971, 974 (5th Cir.), cert. denied, 439 U.S. 834, 99 S.Ct. 116, 58 L.Ed. 2d 130 (1978); see Austral

Oil Co. v. FPC, 560 F.2d at 1266.

J. M. Zachary and his copetitioners seek review of Commission orders denying a replacement contract rate on their sale of natural gas to intervenor Northern Natural Gas Company. The gas purchase agreement involved was executed in 1954 by a seller and buyer to whom petitioners, as working interest owners, and Northern, as buyer, are successors in interest. Duration of the agreement is governed by the term here in dispute, which provides:

> Subject to the other provisions hereof, this agreement shall be in force for an original term from its date until the expiration of a twenty (20) year period following the date hereof and thereafter as long as gas is delivered hereunder in quantities commercial to Seller and Buyer.

[Emphasis added].

In 1975, more than 20 years after the agreement became effective, petitioners gave written notice to Northern that they were terminating the agreement by refusing to deliver more gas thereunder. Petitioners

and Northern then negotiated an interim agreement granting a price increase subject to refund should the Commission disallow the replacement contract rate. The agreement provided for submission of the rate issue to the Commission for a declaratory order. 18 C.F.R. §1.7(c)(1979).

I. Replacement Contract Rate

[1] Petitioners primarily challenge the Commission's decision that the contract did not expire by its own terms upon their cessation of delivery to Northern. The Commission concluded the agreement is not a contract of 20 years' duration, unilaterally terminable thereafter by a refusal to deliver or accept delivery, but rather a "life-of-lease" contract, limited in duration only by the availability of gas in quantities commercial to both seller and buyer. This critical distinction has governed the Commission's implementation of its replacement contract policy.

The Commission has approved filings for

replacement contract rates where the original contract was unilaterally terminated after the expiration of a definite term of years in accordance with a contractual provision extending to each party a unilateral right of termination. E.g., Sun Oil Co., FERC Gas Rate Schedule No. 65, letter order issued October 1, 1979; Gulf Oil Corp., FERC Gas Rate Schedule No. 143, letter order issued October 1, 1979.

On the other hand, the Commission and this Court have held that regardless of any provision for premature termination by either seller or buyer, a contract otherwise unlimited in years of duration does not expire by its own terms for purposes of the replacement contract policy unless terminated by circumstances beyond the parties' control affecting the production of profitable quantities of gas. Superior Oil Co. v. FERC, 569 F.2d at 973-74.

The issue in the present case, therefore, is whether the agreement is of 20 years'

duration and unilaterally terminable thereafter by petitioners, or limited in duration only by the deliverability of commercial quantities. The Commission's interpretation of the disputed contract term in resolving this issue rested on its expertise and familiarity with natural gas contracts. See United Gas Pipe Line Co. v. Memphis Light, Gas & Water Division, 358 U.S. 103, 114, 79 S.Ct. 194, 201, 3 L.Ed.2d 153 (1958); but see Skelly Oil Co. v. FPC, 532 F.2d 177, 179-80 (10th Cir. 1976). We must affirm unless the Commission's decision is unreasonable or inconsistent with the replacement contract policy. Udall v. Tallman, 380 U.S. 1, 16-17, 85 S.Ct. 792, 801, 13 L.Ed.2d 616 (1965); Superior Oil Co. v. FERC, 569 F.2d at 973; Austral Oil Co. v. FPC, 560 F.2d at 1265.

The Commission reasonably concluded that the disputed provision does not couple an original 20-year term with a unilateral right of termination thereafter. The 20-year term is an assurance that neither party would

withdraw from the contract during that period by claiming that quantites delivered were noncommercial. After the first 20 years, however, the "quantities commercial" language became effective, enabling termination of the quantities delivered were noncommercial to either the seller or the buyer. Petitioners have not alleged that quantities delivered under the contract are no longer commercial to them or to Northern.

The interpretation that the contract is terminable only if the quantities deliverable are noncommercial to the seller or the buyer is first founded on the language of the disputed provision. Petitioners contend their cessation of delivery effected a unilateral termination of the agreement. Yet the word "delivered," as the Commission concluded, connotes the "normal flow of gas" from the well rather than the flow as restricted by the seller. Moreover, inclusion of the phrase "quantities commercial" would be superfluous to a unilateral right of termination exercis-

able through cessation of delivery.

The second basis for the Commission's interpretation is the absence of provisions for notice in the event of an exercise of a unilateral right of termination. It is unlikely that the parties would have left an intended right of termination to implication rather than expressly providing therefor. The absence of any provision for notification by the seller of impending termination is significant because a simple notice provision would normally be included in a contract creating a unilateral right of termination.

Third, the Commission's interpretation is founded on an examination of the rate provisions in the context of the entire agreement. The agreement includes a detailed provision enabling the seller to negotiate price increases after the first fifteen years of the contract and at five-year intervals thereafter. Having provided for carefully timed price negotiations, the parties are not likely to have also vested the seller with

the power to simply cease delivery. This would be tantamount to a forced price negotiation that the seller could precipitate at any time.

Rejecting petitioners' argument that the agreement is of 20 years' duration with a unilateral right of termination thereafter, the Commission reasonably concluded it is of unlimited duration, as long as quantities commercial to both parties are deliverable. In this determinative feature, unlimited duration, the agreement is similar to that involved in Superior Oil Co. v. FERC, 569 F.2d 971. As in that case, denial of the replacement contract rate is here consistent with Commission policy, which has reasonably distinguished contracts of unlimited duration from those having a fixed duration. Austral Oil Co. v. FPC, 560 F.2d at 1267.

II. Other Issues

[2] Jurisdiction. Although petitioners themselves sought the declaratory order challenged here, they now contend the Commission

lacked jurisdiction to resolve the issue of contract interpretation, which petitioners wish to litigate in state court. The primary impact of the Commission's decision is upon the rate at which petitioners can sell their gas in interstate commerce, a matter within its jurisdiction. Natural Gas Act §§ 1(b), 4(a), 15 U.S.C.A. §§ 717(b), 717c(a); see Phillips Petroleum Co. v. Wisconsin 347 U.S. 672, 676-78, 74 S.Ct. 794, 795-796, 98 L.Ed. 1035 (1954); Superior Oil Co. v. FERC, 569 F.2d at 974-75.

The proper exercise of jurisdiction in the implementation of the replacement contract policy is not precluded by the incidental but necessary resolution of an issue of contract interpretation, here a matter within the Commission's special competence. See United Gas Pipe Line Co. v. Memphis Light, Gas & Water Division, 358 U.S. at 114, 79 S.Ct. at 201; Louisiana Power & Light Co. v. FERC, 587 F.2d 671, 675-76 (5th cir. 1979).

[3] Evidentiary Hearing. Petitioners

assert the Commission should have conducted an evidentiary hearing or heard oral argument on the issues presented in this case. No evidentiary hearing is required if a question of law rather than a factual dispute is involved. McCulloch Interstate Gas Corp. v. FPC, 536 F.2d 910, 913 (10th Cir. 1976); Otter Tail Power Co. v. FPC, 536 F.2d240, 242 (8th Cir. 1976); Citizens for Allegan County, Inc. v. FPC, 414 F.2d 1125, 1128 (D.C. Cir. 1969).

The interpretation of the disputed contract term in this case presents only a question of law unless ambiguity in the contract requires resort to extrinsic evidence of intent. United States v. Waterman Steamship Corp., 397 F.2d 577; 579 (5th Cir. 1968); Appalachian Power Co. v. FPC, 529 F.2d 342, 347-48 (D.C.Cir.), cert. denied, 429 U.S. 816, 97 S.Ct. 58, 50 L.Ed.2d 76 (1976).

Both petitioners and the Commission contend the agreement is clear and unambiguous,

and their disagreement as to its proper construction does not inject ambiguity into the contract. Vreeland v. FPC, 528 F.2d 1343, 1351 (5th Cir. 1976). No evidentiary hearing was necessary for an interpretation of the contract.

Disposition of the proceeding without oral argument did not violate petitioners' due process rights. Groendyke Transport, Inc. v. Davis, 406 F.2d 1158, 1162 (5th Cir.), cert. denied, 394 U.S. 1012, 89 S.Ct. 1628, 23 L.Ed.2d 39 (1969). The Commission did not abuse its discretion in declining to hear oral argument on the legal issues presented. See Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 543-46, 98 S.Ct. 1197, 1211-1213, 55 L.Ed.2d 460 (1978).

AFFIRMED.

FOOTNOTES

1/ The order was issued by Federal Power Commission. Its successor agency, the Federal Energy Regulatory Commission, issued the order denying rehearing. We will refer to the agencies interchangeably throughout this opinion as "the Commission."

2/ 18 C.F.R. § 2.56a(a)(5) (1979) provides in part:

> Sales of natural gas in interstate commerce for resale may be made at a rate of 52 cents per Mcf (at 14.73 psia), exclusive of all State or Federal production, severance or similar taxes, and subject to the adjustments provided in this § 2.56a, and the escalation provided in paragraph (a)(6) of this section, provided the sale is made pursuant to (i) a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired by its own term on or after January 1, 1973, ...

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunnam, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

J. M. Zachary, et al.) Docket No. R176-123

ORDER GRANTING INTERVENTION
AND TAKING ACTION ON PETITION
FOR A DECLARATORY ORDER

(Issued August 2, 1976)

On May 11, 1976, J. M. Zachary, Neville G. Penrose, H. Barksdale Brown, Frank D. Brown, Jacques T. Schlenger and Mercantile Safe Deposit and Trust, Trustees of the Trusts U/D Donaldson Brown (hereinafter Petitioners) filed a petition for declaratory order pursuant to Sections 1.8(c)(sic), 1.12, and 1.34 of the Commission's Rules of Practice and Procedure 1/ and Sections 4, 5, 7, and 19(a) of the Natural Gas Act. 2/ Petitioners request the Commission to settle a dispute between themselves, as Sellers, and Northern Natural Gas Company, as Buyer,

by determining that a March 15, 1954, contract, ratified by Petitioners, has expired or terminated according to its own terms. Such an interpretation would, under the vintaging policy set forth in Opinion No. 639, 3/ qualify the sales for the new national rate, 4/ as further implemented by Opinion No. 742. 5/ On June 21, 1976, Northern Natural filed an untimely petition to intervene.

The contract clause in question states that:

> Subject to the other provisions hereof this agreement shall be in force for an original term from its date until the expiration of a twenty (20) year period following the date hereof and thereafter as long as gas is delivered in quantities commercial to Seller and Buyer.

On February 26, 1975, Petitioners gave written notice to Northern that they would no longer deliver gas under the 1954 contract and that, therefore, such agreement was terminated pursuant to the above-quoted provision. Petitioners construe the termination

provision to mean that after twenty years the sellers had the option to terminate the agreement. Northern, however, contends that the contract term extends for the life of the commercial production from the dedicated leases. Petitioners further argue that the use of the word "delivered" instead of "produced" distinguished this clause from a "life-of-lease" provision in that Northern had a limited right to receive gas only so long as Petitioners were willing to deliver gas.

We hold that this is a "life-of-lease" contract. Use of the word "delivered", in lieu of "produced" does not justify that interpretation sought by Petitioners. Moreover, the succeeding qualifying language, "in quantities commercial to Seller and Buyer" precludes Seller from unilaterally terminating the contract and requires both parties to agree as to whether the quantities are commercial.

Nor is our decision altered by Petitioners' contention that the instant clause is no different from the one frequently used by contract draftsmen which provides that the contract "will continue after its primary term until cancelled by one of the parties." It is our opinion that had the parties wanted that reading, they would have employed the simpler and more familiar language commonly used in such circumstances. The Commission orders:

(A) Good cause exists to grant intervention in these proceedings to Northern Natural, subject to the rules and regulations of the Commission; Provided, however, that participation of such intervenor shall be limited to matters affecting asserted rights and interests as specifically set forth in the petition to intervene; and provided, further, that the admission of such intervenor shall not be construed as recognition by the Commission that they might be aggrieved because of any order of the Commis-

sion entered in these proceedings.

(B) The questions raised in J. M. Zachary et al. are answered in the text of this order.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

RATES (Rollover contracts)

Before Commissioners: Charles B. Curtis, Chairman; Don S. Smith, Georgiana Sheldon, Matthew Holden, Jr., and George R. Hall.

J. M. Zachary, et al.) Docket No. R176-123

ORDER DENYING APPLICATION FOR REHEARING
(Issued January 31, 1979)

On August 26, 1976, J. M. Zachary, Neville G. Penrose, H. Barksdale Brown, Frank D. Brown, Jacques T. Schlenger and Mercantile Safe Deposit and Trust, Trustees of the Trusts U/D Donaldson Brown (hereinafter petitioners) filed an application for rehearing of the Commission's order herein issued August 2, 1976, which declared a contract under which petitioners sell natural gas to Northern Natural Gas Company (Northern) to be a "life-of-lease" contract, thus finding the Commission's rollover contract policy (and

rate) to be inapplicable to the sale involved. 1/ On September 24, 1976, the Commission granted rehearing for purposes of further consideration.

The contract involved herein was entered into March 15, 1954, by Neville G. Penrose, Inc., seller, (predecessor in interest of petitioners and other working interest owners) and the Permian Basin Pipeline Company, purchaser, predecessor in interest of Northern. 2/ The part of the contract which is in dispute, Paragraph 1, Article VIII, has to do with the term thereof and reads as follows:

> Subject to the other provisions hereof, this agreement shall be in force for an original term from its date until the expiration of a twenty (20) year period following the date hereof and thereafter as long as gas is delivered hereunder in quantities commercial to Seller and Buyer.

The Commission's rollover policy, as restated in Opinion No. 770-A, Docket No. RM75-14, issued November 5, 1976, (National rate proceeding, gas dedicated on or after

January 1, 1973) reads as follows:

> (A) 2.56a(a)(5). Sales of natural gas in interstate commerce for resale may be made at a rate of 52 cents per Mcf (at 14.73 psia), exclusive of all State or Federal production, severance or similar taxes, and subject to the adjustments provided in this Section 2.56a, and the escalation provided in subsection (a)(6), provided the sale is made pursuant to (A) a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired by its own term on or after January 1, 1973, where the prior contract expired by its own terms prior to January 1, 1973; . . .

Northern maintains that the March 15, 1954 contract is a life-of-lease contract and thus cannot be a "prior contract" to support rollover treatment.

On or about February 28, 1975, petitioners gave written notice to Northern that they would no longer deliver gas to Northern under the 1954 contract and that therefore such agreement was terminated in accordance with its terms (i.e., pursuant to Paragraph 1, Article VIII thereof). 3/

The question then is whether the 1954 contract "expired by its own terms." The

Commission order of August 2, 1976, answered this question in the negative, a result which we affirm.

To us it is clear that Paragraph 1, Article VIII, means that during the period of the contract after 20 years either party can terminate the contract if the quantities of gas flowing thereunder are no longer commercial to such party. 4/ The question is whether the language also means that the seller may unilaterally terminate the contract after 20 years by simply choosing to cease delivering the gas "in quantities commercial to seller and buyer" or by stopping deliveries altogether, as we understand petitioners to contend. We believe such an interpretation is unwarranted and that the phrase "is delivered" in the phrase "as long as gas is delivered hereunder in quantities commercial to seller and buyer" has reference only to the normal flow of gas under the contract and does not confer upon seller an arbitrary termination right.

If the original contracting parties had intended the meaning advanced by petitioners it is strange indeed that they would have left such meaning to be read by interpretation into a phrase dealing with termination rights based on noncommercial quantities. The simple and usual way to create such a right would have been to state it, rather than just to imply that the seller could terminate by the unusual means of choking down or stopping deliveries.

Another fact that strongly militates against petitioners' position is the fact that the contract nowhere provides for any notice of termination to be given by seller to buyer. When consideration is given to the large quantities of gas which flow under this contract from all gas dedicated thereunder, 5/ of which the interests represented by petitioners is less than half, 6/ and to the likelihood that sizeable adjustments would have to be made by a pipeline purchaser faced with the loss of such a large quantity of

gas, the fact that the original purchaser did not secure a simple notice of termination provision is strong evidence that no arbitrary termination right was contemplated.

Other parts of the contract support this interpretation as well. Article IX divides the contract term into five-year periods and provides rates for all future periods without mention of any limitation. It says that "during the fourth five-year period and during the Extended Term [the rate shall be] 12.8200 cents per Mcf." Article IX further specifies rates for this period as follows:

> 5. Upon the giving of six (6) months prior notice in writing before the expiration of the third five-year period, and each successive five-year period thereafter, Seller shall have the right to renegotiate with Buyer for a price higher than the aforesaid price to be paid hereunder for all gas delivered during the fourth five-year period and during each five-year period thereafter. In the event the parties fail prior to the beginning of any such five-year period to agree upon a renegotiated price for said gas during the succeeding five-year period, the price for such period in lieu of that payable under this Article IX shall be a price

equivalent to the average of the three (3) highest prices respectively being paid for gas produced and delivered in Lea County, New Mexico at such time by comparable interstate natural gas transmission companies (including Buyer) under contracts providing terms of at lease five years and for the delivery of not less than ten million cubic feet of gas per day, if at the time, there are three comparable interstate natural gas transmission companies; if not, the average shall be of the two highest of such prices. . . . In no event, however, shall the price to be paid for gas to be purchased under this contract during the fourth five-year period and the extended term hereof be less than the applicable price provided for in said period in paragraph 1 of this Article IX, or such higher price as Buyer has theretofore become obligated to pay under the provisions of paragraph number 4 of this Article IX. [Paragraph 4 primarily provides for possible higher prices during the first three five-year periods of the contract based on the highest price paid for gas by buyer in Lea County, New Mexico.]

6. In order to protect Seller from too great a burden in the event of abnormal inflation in prices of commodities generally the prices specified, expressed in cents per Mcf in Section 1 of this Article IX hereof, including the periodic increases, shall be adjusted as hereinafter set forth. . . [This paragraph establishes an additional system of possible price escalations for all periods under the contract not escalated by paragraphs 4 and 5.]

As can be seen, in Paragraph 5 seller is

given the right to renegotiate with buyer for a higher price for the fourth and each succeeding 5 year period upon giving 6 months prior notice in writing before expiration of the preceeding period. However, if Paragraph 1, Article VIII gave buyer the right unilaterally to terminate anytime during the extended term, this would enable him to call for renegotiation of any part of the contract at anytime during the extended term, on threat of stopping deliveries. Moreover, the parties devoted two and a half pages of the contract, as quoted and described above, to what the rate would be during the "fourth five-year period and during the Extended Term" under all foreseeable circumstances. The language used is what the rate "shall be," not what it shall be assuming seller does not exercise his supposed termination right. While these rate provisions are arguably not technically inconsistent with the existence of an arbitrary termination right on the part of seller, we find them to

be much more indicative of the absence of such a right.

Accordingly, we affirm the previous holding that the contract involved herein is a life-of-lease contract.

Our conclusion reached here is similar to that reached by the Court in Keener Oil & Gas Co. v. Consolidated Gas Utilities Corp., 190 F2d 985 (1951). There Consolidated was bound by contract to allow Keener to extract natural gas gasoline from one of its pipelines. The term of the contract was "ten years, and as long thereafter as said pipeline system is continued in use for transporting gas having a gasoline content." When, after expiration of the ten year term, Consolidated ceased transporting wet gas through the pipeline because its wells supplying the gas were virtually depleted, and substituted other gas (dry) which it purchased, the question arose as to whether the contract had been legally terminated. The Court applied a good faith test, holding

that the contract had been legally terminated because "Consolidated, acting in good faith and under facts and circumstances which made it reasonable so to do, ceased to use its 14-inch line for the transportation of gas having a gasoline content." [Emphasis supplied.] The Court intertained no notion that the language used to express the contract term gave Consolidated any termination right exercisable by arbitrarily ceasing transportation of wet gas through the line. In this connection the Court said, p. 990:

> We think the obligation to act in good faith required Consolidated to deliver gas produced by it from its wells in the East Panhandle Field to Keener's plant for extraction of its gasoline, butane, and propane content after the expiration of the 10-year period, so long as the wells of Consolidated in the East Panhandle Field produced gas in sufficient quantities to meet Consolidated's requirements. . . . [Emphasis supplied.]

One other point should be mentioned. In their application for rehearing, p. 6, petitioners state:

> The Commission erred in not taking evidence. Petitioners would show in-

> equities, misrepresentations and economic coercions which will void the Contract from its inception, and prior to the time that the sales thereunder became subject to the jurisdiction of the Federal Power Commission, thereby making the contractual relationship between Buyer and Seller one terminable at will from its inception.

Even if the contract were terminable at will by petitioners due to the above-mentioned "inequities, misrepresentations and economic coercions," it would not change it into a "prior contract" (which would support rollover treatment) within the meaning of the Commission's rollover contract policy. It is the primary term of the contract that controls, and premature termination, or the possibility thereof, has no bearing for rollover purposes. Opinion No. 770-A, supra, mimeo. p. 22. See also Skelly Oil Company, FPC Gas Rate Schedule No. 228, issued February 14, 1977.

The Commission finds:

Petitioners' applications for rehearing presents no new facts or principles of law which warrant any modification of our August

2, 1976 order.

The Commission orders:

Petitioners' application for rehearing filed herein August 26, 1976, is hereby denied.

By the Commission. Chairman Curtis voted present.

(S E A L)

Kenneth F. Plumb,
Secretary.

-xxx-

FOOTNOTES

1/ This proceeding was commenced before the FPC. By the joint regulation of October 1, 1977 (10 CFR 1000.1), it was transferred to the FERC. The term "Commission", when used in the context of action taken prior to October 1, 1977, refers to the FPC; when used otherwise, the reference is to the FERC.

2/ The contract is on file with the Commission as a part of Sohio Petroleum Company FERC Gas Rate Schedule No. 63.

3/ The gas has nevertheless continued to flow uninterruptedly. Petitioners and Northern entered into an "interim Agreement" on January 21, 1976, providing, inter alia, for the continued sale of the gas during pendency of this proceeding.

4/ No one is contending that the quantities of gas flowing are not commercial.

5/ The contract called for seller to make available to buyer 2.67 MMcf of gas per day (975 MMcf per year). An early 1976 filing showed estimated annual volumes to be over 1,000 MMcf.

6/ Rates for gas of other interest owners under the contract have not been increased on the basis of "rollover".

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 19

No. 79-1754

F.E.R.C. No. RI76-123

J. M. ZACHARY, ET AL.,

Petitioners,

versus

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

- - - - - -

Petition for Review of An Order of the
Federal Energy Regulatory Commission

- - - - - -

Before CHARLES CLARK, RONEY and GARZA,
Circuit Judges.

J U D G M E N T

This cause came on to be heard on the petition of J. M. Zachary, Et Al. for review of an order of the Federal Energy Regulatory Commission, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the petition for review of an order of the

Federal Energy Regulatory Commission in this cause be, and the same is hereby affirmed.

July 9, 1980

Issued as Mandate: July 31, 1980

NATURAL GAS ACT SECTION 4(e)
[U.S. Code, title 15, sec. 717c(e).]

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission or gas distributing company, or upon its own initiative without the complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or ser-

vice goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective . . .

NATURAL GAS ACT SECTION 5
[U.S. Code, title 15, sec. 717d.]

(a) Whenever the Commission, after a hearing and upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order . . .

NATURAL GAS ACT SECTION 19(b)

(b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business . . . Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satis-

faction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification . . . Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

28 U.S.C. §1254

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree; . . .

CERTIFICATE OF SERVICE

I certify that I have mailed on this _____ day of October, 1980, three true and correct copies of the above and foregoing Petition for Writ or Certiorari by the Petitioners, J. M. Zachary, et al. by certified mail, return receipt requested to the following:

Solicitor General
Department of Justice
Washington, D.C. 20530

Joseph G. Stiles
Federal Energy Regulatory Commission
Room 8712
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Washington, D.C. 20426

Patrick J. McCarthy
Northern Natural Gas Co., Inc.
2223 Dodge Street
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_____
PHILIP R. BISHOP